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No. 91-188

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IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1991

BROOKHURST, INC., AS SUCCESSOR BY MERGER WITH COMMERCIAL UNIFORM COMPANY,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

REPRINTED COPY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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1. Does the Government's unsolicited return of taxes following timely payment by a taxpayer constitute an erroneous refund?

2. When the Government unilaterally refunds a timely-paid tax, is the tax deemed "unpaid" by reason of such refund?

3. Can the Government arbitrarily assess and collect an erroneous refund foisted on a taxpayer without bringing an erroneous refund action under 26 U.S.C. §7405?

4. Is the Government entitled to recover interest on an erroneous refund that is not recoverable by suit pursuant to 26 U.S.C. §7405?

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NO. 89-55228

IN THE

SUPREME COURT

OF THE UNITED STATES

BROOKHURST, INC., AS SUCCESSOR BY MERGER WITH COMMERCIAL UNIFORM COMPANY,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI

The petitioner, BROOKHURST, INC., as Successor by Merger with Commercial Uniform Company, respectfully prays that a writ of certiorari issue to review the

judgment and opinion of the United States Court of Appeals for the Ninth Circuit, entered in this proceeding on April 24, 1991.

OPINION BELOW

The opinion of the Court of Appeals is reproduced in the Appendix hereto. (App. A).

JURISDICTION

The statutory basis of subject matter jurisdiction of the United States District Court for the Central District of California was based upon 28 U.S.C. §1346(a)(1) and 26 U.S.C. §7422(a).

Final judgment with respect to all of the issues presented was entered by the District Court on January 29, 1989. The statutory basis for jurisdiction of the Court of Appeals for the Ninth Circuit was based upon 28 U.S.C. §1291 and 28 U.S.C. §1294(1).

The judgment of the Court of Appeals for the Ninth Circuit was entered on April 24, 1991. The statutory basis for jurisdiction of the United States Supreme Court is based upon 28 U.S.C. §1254(1).

STATEMENT OF THE CASE

Brookhurst[1] timely filed its Employer's Quarterly Federal Tax Return (Form 941) for the fourth quarter of 1983 and paid the liability shown on the return in the amount of $194,874.76 through regular federal tax deposits at an authorized financial institution and through other payments to the Internal Revenue Service.

On May 7, 1984, the Internal Revenue Service entered an assessment for Brookhurst's fourth quarter 1983 payroll taxes for $971.82 instead of

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[1]The term "Brookhurst" includes Commercial Uniform Company which merged with Brookhurst, Inc. prior to the initiation of the District Court proceeding.

the correct amount of $194,874.76, and erroneously refunded $195,810.51 to Brookhurst. Brookhurst promptly notified the Internal Revenue Service that it was not entitled to a refund.

Despite Brookhurst's notice that it was not entitled to a refund, the Service took no action for more than two years. On May 19, 1986, the Internal Revenue Service assessed Brookhurst for employment taxes for the fourth quarter of 1983 in the amount of $193,902.91 (representing the $194,874.76 shown on Brookhurst's fourth quarter 1983 employment tax return less the $971.82 entered as an assessment on May 7, 1984), plus interest of $57,234.34. Between December 1986 and March 1987, the

Internal Revenue Service utilized its summary collection procedures to recover the $195,810.51 erroneous refund plus interest and late payment penalties.

Brookhurst timely filed an administrative Claim for Refund on February 2, 1987 seeking to recover the $195,810.51 plus interest and late payment penalties seized by the Service. By Notice dated April 15, 1987, the Internal Revenue Service disallowed the Claim for Refund. Thereafter, Brookhurst timely filed a Complaint for Refund in the United States District Court for the Central District of California, claiming that the government's sole remedy was

under 26 U.S.C. §7405[2] , which remedy was barred by the statute of limitations imposed under 26 U.S.C. §6532[3].

The District Court held that the Internal Revenue Service had the authority to recover $193,902.91 from Brookhurst but that it did not have the authority to assess and collect the related interest and penalties. Cross-appeals relating to the tax and interest followed. The District

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[2]"Any portion of a tax imposed by this title which has been erroneously refunded (if such refund would not be considered as erroneous under section 6514) may be recovered by civil action brought in the name of the United States." 26 U.S.C. §7405(b).

[3]"Recovery of an erroneous refund by suit under section 7405 shall be allowed only if such suit is begun within 2 years after the making of such refund . . ." 26 U.S.C. §6532(b).

Court's holding that the late payment penalty was improperly assessed and collected was not appealed.

On cross-appeal, the Court of Appeals for the Ninth Circuit affirmed that the Internal Revenue Service had the authority to recover $193,902.91 from Brookhurst through assessment and collection procedures. Additionally, the Court of Appeals held that the Internal Revenue Service had the authority to assess and collect interest from the date of the refund.

REASONS FOR GRANTING THE WRIT

1. **THE COURT SHOULD DETERMINE WHETHER A TAX BECOMES UNPAID WHEN THE GOVERNMENT SENDS A TAXPAYER AN UNSOLICITED CHECK.**

The decision below implies that Brookhurst's taxes were not paid until full and formal assessment occurred. The circuit courts are split on the issue. Additionally, the Court of Appeal's holding that the taxes were "unpaid" by the erroneous refund ignores (i) the recognized distinction between erroneous refunds resulting from affirmative action by the taxpayer and erroneous refunds generated solely by the Internal Revenue Service and (ii) the impossibility of

rationalizing the result where the Government's payment exceeds the taxes that were paid.

A. A CONFLICT EXISTS AMONG THE CIRCUITS ON THE ISSUE OF WHEN A TAX IS DEEMED "PAID."

The time a tax is deemed "paid" is important in determining the period of limitations in the tax field. For example, the payment of tax begins the running of the limitations period for claims for refund. However, present case law is uncertain as to when "payment" occurs. The Ninth Circuit decision below implies that a tax is not paid until full and formal assessment occurs. The majority of the circuits, however, have held that a

tax is paid when either the taxpayer makes a remittance with a manifested intent to discharge a recognized tax obligation or when both payment and formal assessment occur.

The split among the circuits stems from the two interpretations given to the Supreme Court's opinion in Rosenman v. United States, 323 U.S. 658, 65 S.Ct. 536 (1945). Rosenman involved the definition of "payment" for purposes of the commencement of the running of the statute of limitations on claims for refund. The Supreme Court held that the statute of limitations commenced running only after the Commissioner's formal assessment. 323 U.S. at 661, 65 S.Ct. at 538. An

important factor was the taxpayer's lack of intent to discharge an asserted liability. In Rosenman, the taxpayer only intended to remit the amounts paid as a deposit to cover whatever contingencies may occur in the future. 323 U.S. at 662, 65 S.Ct. at 538.

The majority position is that either assessment or the taxpayer's intent to make a payment will be sufficient for a remittance to be deemed "payment." Fortugno v. Commissioner, 353 F.2d 429 (3d Cir. 1965). See also Ehle v. United States, 720 F.2d 1096, 1097 (9th Cir. 1983). In Ewing v. United States, 914 F.2d 499 (4th Cir. 1990), the Court analyzed prior cases

interpreting the holding in Rosenman and held that:

> These cases . . . reason that, for purposes of deciding whether a remittance was a payment of tax, formal assessment is only one factor to be considered. Other factors deemed relevant have included when the tax liability is defined, the taxpayer's intent in remitting the money, and how the IRS treats the remittance upon receipt. 914 F.2d at 503.

The rule enunciated by the majority of the Courts of Appeal that have considered the question is that "payment" occurs when a taxpayer files his return accompanied by his payment (if the tax is self-assessed by the taxpayer). Ameel v. United States, 426 F.2d 1270, 1272 (6th Cir. 1970). In the present case, the

taxpayer filed its tax return on time, accompanied with a remittance in the full amount of the tax due as shown on the return. According to the majority of the circuits, the taxpayer's self-assessment constituted "payment." However, in the instant case, the Ninth Circuit allowed the Internal Revenue Service to unilaterally assess the tax liability for the amount erroneously refunded but previously paid, implying that it was never fully paid because it was never assessed prior to the issuance of the erroneous refund. This holding conflicts with the indication of the Ninth Circuit's prior position in Ehle v. United States, 720 F.2d 1096 (9th Cir.

1983). In Ehle, the Court recognized that "a transfer of money to the IRS would be deemed a 'payment' only when the taxpayer's intent was to make a payment or the IRS had formally assessed the tax." 720 F.2d at 1097 (emphasis added). This implies the adoption of the majority view of Rosenman. Here, however, the Ninth Circuit chose to adopt the minority position.

The minority view is that formal assessment is necessary for a tax to be deemed "paid." Thomas v. Mercantile Nat'l Bank, 204 F.2d 943, 944 (5th Cir. 1953). See also United States v. Dubuque Packing Co., 233 F.2d 453, 462 (8th Cir. 1956) ("[I]t is the act of assessment that starts

the running of the statute."); Plankinton v. United States, 267 F.2d 278, 280 (7th Cir. 1959) ("[G]enerally remittances of tax made prior to the time the taxpayer's liability is defined do not constitute 'payment' of a tax . . ."). In Mercantile National Bank, 204 F.2d 943 (5th Cir. 1953), the Fifth Circuit created a per se rule based on Rosenman that there is no payment of taxes until there is an assessment certified by the Commissioner. Mercantile Nat'l Bank, 204 F.2d at 944. The Fifth Circuit reasoned that the tax could not be paid before formal assessment because there was no tax liability prior to

assessment. Id. This per se rule was followed in Ford v. United States, 618 F.2d 357 (5th Cir. 1980). However, the court in Ford cast doubt upon the validity of the Mercantile National Bank rule by noting its inconsistency with the concept of voluntary self-assessment that is basic to our tax system. 618 F.2d at 360. Such a concept is also inconsistent with the civil and criminal penalties generated by failure to withhold and pay over employment taxes.[4]

It is important that the Court resolve the conflict among the circuits in this area. The

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[4]See 26 U.S.C. §§6651(a)(2), 6656(a), 6672(a), and 7202 set forth in pertinent part in Appendix C.

definition of "payment" within the context of tax litigation is very important. Because payment defines a variety of items in the tax field, conflicting opinions result in inconsistent application of the tax laws.

B. THE NINTH CIRCUIT'S HOLDING THAT A TAX IS UNPAID BY AN ERRONEOUS REFUND IS IN CONFLICT WITH EXISTING COURT DECISIONS.

In the decision below, the Ninth Circuit held that the employment taxes were "unpaid" by the issuance of an erroneous refund. Brookhurst, Inc. v. United States, No. 89-55228, slip op. 5151, 5161 (9th Cir. April 24, 1991). Therefore, the court reasoned, the

unpaid taxes could be assessed and collected by the government through its ordinary assessment procedures. Id. at 5158-59. The Court's conclusion is subject to question where the amount "refunded" is unrelated to the amount owing--if the "refund" was greater than the tax shown on the return, there would not be any taxes left to "unpay." In effect, the wild "refund" check had nothing to do with any basis of taxation or any claim of the taxpayer.

In Kelley v. United States, 30 F.2d 193 (9th Cir. 1929), the Court of Appeals for the Ninth Circuit stated "When once paid, a tax is gone, and a refund of the money

does not restore it." 30 F.2d at 193. Counsel for the government in the present case recognized this long-standing principle: "We are not -- I repeat -- we are not saying that the refund of erroneous -- excuse me -- erroneous refund by itself reinstituted original assessment. That is not what we are saying." Amended Excerpts of Record at 64, Brookhurst v. United States, No. 89-55228, slip op. 5151 (9th Cir. April 24, 1991). However, in the decision below, the Ninth Circuit disregards its prior Kelley decision and holds that a tax can be "unpaid" by a subsequent erroneous refund. Brookhurst, No. 89-55228, slip op. at 5161.

The Tax Court and several district courts have passed on the question of whether a tax is unpaid by a subsequent refund, creating a body of law that is somewhat ambiguous. In Rodriguez v. United States, 629 F.Supp. 333, 344 (N.D.Ill. 1986), the court held that a refund does not revive or continue a pre-existing tax liability. However, this decision was interpreted as applying only in instances where a previously-assessed liability was extinguished and subsequently refunded. Tucker v. United States, 89-1 USTC ¶9336 (S.D.N.Y. 1989). The court in Rodriguez, however, recognized that an exception to the general rule

exists when the taxpayer takes affirmative action to cause the refund. Rodriguez, 629 F.Supp. at 345. This distinction between taxpayer-induced and IRS-induced refunds was also noted by the court in Burns v. United States, 90-2 USTC ¶50,479 (S.D.Fla. 1990). In Burns, the taxpayer argued that the previously-paid tax was not revived by the subsequent refund. The court noted:

> All of the authorities cited . . . concern a situation in which the IRS had committed an error subsequent to a taxpayer's satisfaction of a deficiency, yet nevertheless attempted to bootstrap its own error into a resuscitation of the already-satisfied deficiency. By contrast, in the case at bar the entire chain of events was

> triggered by [the taxpayer's] affirmative act . . . not through the fault of the government. 90-2 USTC at 85,570.

In United States v. Young, 79-2 USTC ¶9609 (D.Del. 1979), due to a mistake at the IRS, the taxpayer received a refund of the amount he sent in as payment on a deficiency. The court stated, "[T]he issuance of an erroneous refund by the Treasury Department cannot revive a deficiency assessment which has already been satisfied." 79-2 USTC at 88,221. Pesch v. Commissioner, 78 T.C. 100 (1982), limited Young to cases where the refunded payment satisfied a previously-assessed liability. Id. at 120.

In Daniels v. Commissioner, 35 T.C.M. 784 (1976), the IRS disallowed a deduction claimed by the taxpayers, reducing the amount of their refund by the deficiency amount. Later, the taxpayers received a refund check in the amount of the deficiency. Although the taxpayers argued that they had "paid" the deficiency through the reduction in their first refund, the court held that "[t]he return of the amount of the deficiency invalidated the effect of any 'payment.'" 35 T.C.M. at 784. This case is distinguishable from the present case because, in Daniels, the taxpayers had claimed a deduction for the same amount as the erroneous refund. Therefore, some type of

affirmative action was taken by the taxpayers.

Only the acts of the taxpayer can "unpay" a previously-satisfied tax. Rodriguez, 629 F.Supp. at 345. In this case, Brookhurst timely filed its return and paid the correct tax amount. The taxpayer did not affirmatively act to cause the refund. In fact, the taxpayer immediately notified the IRS that the refund was erroneous. It was the government's error that caused the refund. Therefore, the taxpayer does not come within the narrow exception recognized in Rodriguez.

The decision below ignores the distinction recognized by other

courts between refunds sought affirmatively by the taxpayer and refunds caused solely by the mistakes of the IRS.

2. PRESENT LAW DOES NOT CLEARLY DEFINE WHETHER AN ERRONEOUS REFUND FOISTED ON THE TAXPAYER MAY BE RECOVERED BY ASSESSMENT AND COLLECTION WITHOUT BRINGING SUIT UNDER 26 U.S.C. §7405.

Since 26 U.S.C. §7405 was enacted, taxpayers have argued that this section creates the exclusive remedy of the Internal Revenue Service for recovery of an erroneous refund. Although courts have held that the remedy under 26 U.S.C. §7405 is not always the sole basis for recovery by the Internal Revenue

Service, an action under that section should be the exclusive remedy where the taxpayer does not request, seek, or encourage the refund in any way. Here, the refund was generated solely by the acts of the Internal Revenue Service. The Court has the opportunity, in this case, to decide whether a payment by the Internal Revenue Service, not induced by the taxpayer, can be recovered without bringing an action under 26 U.S.C. §7405.

Present case law allows the Internal Revenue Service to recover erroneous refunds induced by taxpayer action either through a suit pursuant to 26 U.S.C. §7405 or through deficiency procedures under 26 U.S.C.

§6212. Warner v. Commissioner, 526 F.2d 1 (9th Cir. 1975); Beer v. Commissioner, 733 F.2d 435 (6th Cir. 1984). In Milleg v. Commissioner, 19 T.C. 395 (1952), the Tax Court held that the allowance of a claim for refund was not a final determination, and therefore:

> [i]n the absence of a closing agreement, valid compromise, final adjudication or the running of the statute of limitations, the [Internal Revenue Service] may make a new and different assessment against the same taxpayer, for the same year, and in respect of the same type of tax. 19 T.C. at 398 (citing William Fleming, 3 T.C. 974 (1944), aff'd, 155 F.2d 205 (5th Cir. 1946)).

These cases all involved a claim for refund on the part of the taxpayer. Here, the taxpayer did not

claim a refund, did not file an erroneous return, and did not fail to pay the required amount. The Internal Revenue Service generated the erroneous refund through a computer error.

The legislative history of Section 610 of the Internal Revenue Bill of 1928, which is the predecessor to 26 U.S.C. §7405, states the following:

> Section 610. Recovery of Amounts Erroneously Refunded.
>
> This section relates to the recovery of erroneous refunds as defined in section 608 and also to refunds which are erroneous independently of section 608. The section provides that any erroneous refund, of either class, may be recovered by suit brought in the name of the United States if such suit

> is begun within two years after the making of the refund. Obviously, if the limitation period on the making of assessments has not expired, the erroneous refund may be recovered by assessment in the ordinary manner. S. Rep. No. 960, 70th Cong., 1st Sess. (1928), 1939-1 C.B. (Pt.2) 409, 438.

Although the Senate Report states that the refund may be recovered through assessment, it may refer only to those refunds which are taxpayer-induced. See Burns v. United States, 90-2 USTC ¶50,479 (S.D.Fla. 1990); Radinsky v. United States, 622 F.Supp. 412, 414 (D.Colo. 1985).

In Groetzinger v. Commissioner, 69 T.C. 309 (1977), the taxpayer did not request the refund. The erroneous refund was a mistake on the part of the Internal Revenue

Service. The Tax Court held that Section 7405 does not preclude recovery through assessment procedures. 69 T.C. at 312-13. However, Groetzinger has not gone uncontradicted.

Several cases imply that an erroneous refund suit pursuant to 26 U.S.C. §7405 is the sole remedy of the government in cases where the erroneous refund is the fault of the government. In United States v. Wurts, 303 U.S. 414, 416, 58 S.Ct. 637, 638 (1938), the Supreme Court recognized that Section 610 of the 1928 Act, the predecessor of 26 U.S.C. §7405, was a limitation on the right to recover erroneous refunds. The Court stated:

> Section 610 of the 1928 Act, relied upon as barring recovery of this erroneous and unwarranted tax refund, does not grant the Government a new right, but is a limitation of the Government's long-established right to sue for money wrongfully or erroneously paid from the public treasury. 303 U.S. at 415-16, 58 S.Ct. at 638 (emphasis added).

In Burns v. United States, 90-2 USTC ¶50,479 (S.D.Fla. 1990), the court stated:

> One purpose for a strict adherence to Section 7405 is to prevent the government from using its prodigious tax-collecting arsenal in the effort to rectify its own erroneous refunds. 90-2 USTC at 85,570.

Although the Court later determined that a suit under 26 U.S.C. §7405 was not required because the refund was caused by an affirmative act of the

taxpayer, this language demonstrates that the Court believed that the legislature intended Section 7405 to be a limitation on the right to recover erroneous refunds, and that a Section 7405 suit was the only remedy in situations where the government caused the refund.

In Radinsky v. United States, 622 F.Supp. 412, 414 (D.Colo. 1985), the Internal Revenue Service sent a refund to the wrong taxpayer. The Court stated:

> The United States misperceives the issue in this matter as whether the plaintiffs were initially entitled to the money. The dispositive issue is instead whether the IRS has followed the law in collecting the money it mistakenly sent to the plaintiffs. While this court is aware that the

> plaintiffs may receive a windfall, the IRS can only recover the sum pursuant to powers granted by Congress. The United States Code allows the IRS to bring a civil action under 26 U.S.C. §7405 to recover refunds mistakenly paid to the wrong taxpayer. . . . Congress certainly knew that by imposing a strict statute of limitations persons who, for example, received erroneously large refunds could 'keep money that did not belong to them' . . . unless the IRS promptly brought a civil action to recover the money. Any windfall is a result of Congressional action, and there is no convincing distinction between a refund that is too large and a refund that is sent to the wrong person. 622 F.Supp. at 414.

The language in Radinsky implies that a Section 7405 action is a limitation on the government's right to recover

monies erroneously paid because of its own mistakes.

In Akers v. United States, 541 F.Supp. 65 (M.D.Tenn. 1981), the taxpayers fully paid their assessed deficiency. The Internal Revenue Service then mistakenly refunded their payment and then tried to collect it as an unpaid part of the original assessment. The court held that the proper procedure for recovery was a suit under 26 U.S.C. §7405, rejecting the Internal Revenue Service's assertion that the refund could be recovered like any other unpaid assessment. 541 F.Supp. at 67 (citing United States v. Young, 79-2 USTC ¶9609 (D.Del. 1979); LaFollette

v. United States, 176 F.Supp. 192 (S.D.Cal. 1959)).

When the Internal Revenue Service generates an erroneous refund as a result of its own mistake, without any affirmative act of the taxpayer, an action under 26 U.S.C. §7405 should be its exclusive remedy. If, through its lack of diligence, the Internal Revenue Service does not bring the proper action within the period prescribed by Congress under 26 U.S.C. §6532(b), it should be barred from recovery of the erroneous refund.

From the foregoing, it is apparent that there is a need for this Court to clarify whether, in the situation presented, a civil action

under 26 U.S.C. §7405 is the exclusive remedy of the Internal Revenue Service for recovery of an erroneous refund.

3. THE NINTH CIRCUIT IMPOSED INTEREST ON AN ERRONEOUS REFUND WITHOUT STATUTORY AUTHORITY.

In the decision below, the Ninth Circuit imposed interest on the erroneous refund under 26 U.S.C. §6601(a). This section provides:

> If any amount of tax imposed by this title (whether required to be shown on a return, or to be paid by stamp or by some other method) is not paid on or before the last date prescribed for payment, interest on such amount at the underpayment rate established under section 6621 shall be paid for the period from such last date to the date paid. 26 U.S.C. §6601(a) (emphasis added).

In order to impose interest under 26 U.S.C. §6601(a), the tax must have been unpaid "on or before the last date prescribed for payment." In this case, the taxpayer timely filed its return and timely paid the proper tax amount. Therefore, the tax was paid on or before its due date. Ameel v. United States, 426 F.2d 1270, 1272 (6th Cir. 1970). However, the court below held that the tax was "unpaid" by reason of the erroneous refund. Brookhurst, Inc. v. United States, No. 89-55228, slip op. 5151, 5161 (9th Cir. April 24, 1991).

Assuming that the Ninth Circuit erred, and a tax does not become "unpaid" by a subsequent refund, there is no provision in the

Internal Revenue Code that allows the imposition of interest on the taxpayer unless the Commissioner has the right to bring suit under 26 U.S.C. §7405 for recovery of the erroneous refund.

> Any portion of an internal revenue tax (or any interest, assessable penalty, additional amount, or addition to tax) which has been erroneously refunded, and which is recoverable by suit pursuant to section 7405, shall bear interest at the underpayment rate established under section 6621 from the date of the payment of the refund. 26 U.S.C. §6602 (1991).

In this case, the erroneous refund suit under 26 U.S.C. §7405 was barred by the two year statute of limitations imposed by 26 U.S.C.

§6532(b). Therefore, interest cannot be imposed under 26 U.S.C. §6602.

Assuming arguendo that the Ninth Circuit was correct in holding that the refund "unpaid" the previously-satisfied tax liability, Avon Products, Inc. v. United States, 588 F.2d 342, (2d Cir. 1978), holds that "interest shall begin running when a tax becomes both due and unpaid." 588 F.2d at 344 (emphasis added). The Ninth Circuit states, "The government's supplemental assessment of Brookhurst's income taxes created a new tax obligation which Brookhurst was obligated to pay." Brookhurst, No. 89-55228, slip op. at 5160. The court admits that the obligation was not created until

the supplemental assessment. Therefore, the tax could not be due prior to the date of the supplemental assessment. Interest cannot possibly accrue prior to the date of reassessment, the date at which the tax arguably may have been both due and unpaid.

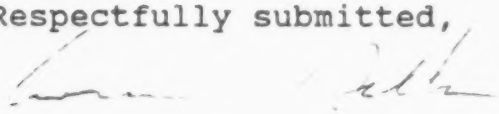
Because Sections 6601 and 6602 do not apply in this instance, the Ninth Circuit was without authority to impose any interest on the erroneous refund. Even if the refund is deemed to have unpaid the tax "on or before the last day prescribed for payment," at most, interest can only be imposed from the date of the supplemental assessment of the tax.

CONCLUSION

Tax procedure is entirely a creature of statutes enacted by Congress. If a taxpayer fails to file a claim for refund on a timely basis, the taxpayer is barred from recovering amounts that may be justly due and owing. Likewise, the Internal Revenue Service should be barred from proceeding where it fails to follow the procedural mandates set forth in the Internal Revenue Code as prescribed by Congress. It is therefore respectfully requested that the Petition for a Writ of Certiorari

should be granted and the decision of the Court below reversed.

Respectfully submitted,



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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BROOKHURST, INC., AS SUCCESSOR BY MERGER WITH COMMERCIAL UNIFORM COMPANY, Plaintiff-Appellant, v. UNITED STATES OF AMERICA, Defendant-Appellee.	No. 89-55228 D.C. No. CIV 87-03835-JGD
BROOKHURST, INC., AS SUCCESSOR BY MERGER WITH COMMERCIAL UNIFORM COMPANY, Plaintiff-Appellee, v. UNITED STATES OF AMERICA, Defendant-Appellant.	No. 89-55265 D.C. No. CIV 87-03835-JGD OPINION

Appeal from the
United States District Court
for the
Central District of California
John G. Davies, District Judge

Argued and Submitted
March 5, 1991--Pasadena, California

Filed April 24, 1991

Before: William C. Canby, Jr. and Pamela Ann Rymer, Circuit Judges, and David F. Levi, District Judge.

OPINION

CANBY, Circuit Judge:

This appeal presents the question whether the government is entitled to collect an erroneously paid employment tax refund by assessment and levy. The parties have stipulated to the following facts.

On January 21, 1984, Brookhurst filed its Employer's Quarterly

Federal Tax Return for the fourth quarter of 1983, reporting a $194,874.76 employment tax liability. Brookhurst paid this amount to the United States through periodic federal tax deposits and by way of two payments made in January and February 1984.

In May 1984, an IRS agent mistakenly assessed Brookhurst's liability for the fourth quarter of 1983 as $971.82. As a result, a tax credit for the fourth quarter of 1983 was entered, which in turn resulted in the mistaken recording of an overpayment. Consequently, the IRS prepared a refund to Brookhurst of the erroneously calculated overpayment plus $1,908.17 in

interest for a total refund of $195,810.51. On May 7, 1984, the IRS notified Brookhurst that it would receive a refund in this amount. Brookhurst returned a copy of the notice with the notation, "our records indicate that our return was correctly filed. Please review your records and advise. Thank you." Brookhurst received the erroneous refund check on May 10, 1984, and deposited it into its corporate account shortly thereafter.

Two years later, the IRS realized its mistake. On May 19, 1986, the IRS entered a new employment tax assessment for the fourth quarter of 1983 in the amount of $193,902.91, plus $57,234.34 in

interest. A notice of demand for payment of the taxes was issued to Brookhurst on the same day. Through levies issued between December 1986 and March 1987, the IRS collected the newly assessed employment tax, plus $72,671.09 in interest, $7,898.44 in failure-to-pay penalties, and $36.00 in fees and collection costs for a total of $274,508.44.

Brookhurst initiated this action against the IRS to recover the $274,508.44.[1] The district court held that the government could properly collect the erroneous refund through levies, but that it lacked

---

[1]Brookhurst first exhausted its administrative remedies by filing an administrative claim for a refund. The IRS denied the claim in April 1987.

statutory authority to assess interest or failure-to-pay penalties on the erroneous refund. The district court also denied Brookhurst's request for attorneys' fees and costs.

Brookhurst appeals the district court's decision that the government properly collected the erroneous refund. The government cross-appeals the district court's determination that it lacked statutory authority to assess interest on the refunded monies.[2] Additionally, Brookhurst requests attorneys' fees and costs

---

[2]The government does not challenge the district court's determination that it lacked authority to impose failure-to-pay penalties pursuant to 26 U.S.C. §6551(a).

pursuant to section 26 U.S.C. §7430. We affirm on Brookhurst's appeal and reverse on the government's cross-appeal.

ANALYSIS

1. Recovery of the erroneous refund.

The government relied on Internal Revenue Code section 6204(a) and 6502(a)(1) in reassessing Brookhurst's tax liability and collecting the reassessed taxes by levy. These sections provide:

> The secretary may, at any time within the period for assessment, make a supplemental assessment whenever it is ascertained that any assessment is imperfect or incomplete in any material respect.

26 U.S.c. §6204(a) (1988).

> Where the assessment of any tax imposed by this title has been made within the period of limitation properly applicable thereto, such tax may be collected by levy or by a proceeding in court, but only if the levy is made or the proceeding begun--
>
> (1) within 6 years after the assessment of the tax . . . .

26 U.S.C. §6502(a)(1) (1988).

[1] Brookhurst contends that the government wrongfully collected the refunded monies by levy. Brookhurst asserts that the government could only recover the monies by commencing a civil action pursuant to section 7405(a) of the Code.[3] Such an action

---

[3]Section 7405 (a), entitled "Action for recovery of erroneous refunds," provides:

> **Refunds after limitation period.**--Any portion of a

must be commenced within two years of the refund. 26 U.S.C. §6532(b). Because the limitations period has expired, Brookhurst asserts that the government is not entitled to collect the refunded monies.

[2] Brookhurst concedes, as it must, that the government may utilize any procedure authorized by the Internal Revenue Code to collect taxes owed. The courts uniformly have upheld the government's employment of summary collection procedures. See Beer v.

> tax imposed by this title, refund of which is erroneously made within the meaning of section 6514, may be recovered by civil action brought in the name of the United States.

26 U.S.C. §7405(a) (1988).

Commissioner, 733 F.2d 435 (6th Cir.), cert. denied, 469 U.S. 857 (1984); Ideal Realty Co. v. United States, 561 F.2d 1123 (4th Cir. 1977); Warner v. Commissioner, 526 F.2d 1, 2 (9th Cir. 1975); C & R Investments, Inc. v. United States, 444 F.2d 765 (10th Cir. 1971). Brookhurst argues that the tax collection procedures authorized by the Code and discussed in the previously cited decisions are not applicable to the present case because Brookhurst owes no taxes; Brookhurst contends that it satisfied its 1983 fourth quarter tax liability by paying the full amount of taxes owed in February 1984. According to Brookhurst, a tax once paid cannot be

revived by a subsequent refund. Brookhurst relies on United States v. Young, 79-2 U.S. Tax Cas. (CCH) ¶9609 (1979) and Kelley v. United States, 30 F.2d 193 (9th Cir. 1929).

In United States v. Young, 79-2 U.S.T.C. (CCH) ¶9609 (1979), the IRS assessed a penalty against Young for failure to pay his employee withholding tax. In February 1971, the taxpayer paid the penalty in full, but the IRS mistakenly credited the payment to Young's sole proprietorship account instead of his individual account. Because this account was current, the IRS refunded to the taxpayer the penalty payment and interest. Over five years later, the IRS brought an action to recover

the erroneous refund plus interest. The taxpayer moved for summary judgment on the ground that the action was barred by the two-year statute of limitations for commencing such an action. The government countered that the six-year limitations period for collection of overdue assessments governed the action. Noting that the government had conceded that the original assessment was paid in full, the court concluded that the suit was designed to recover an erroneous refund and was therefore subject to the two-year statute of limitations period.

In Kelley v. United States, 30 F.2d 193 (9th Cir. 1929), the IRS

accepted an executrix's application for a refund of half of the previously paid estate taxes. The IRS later brought an action in equity to recover the refund, claiming that it had been improperly granted because of an erroneous interpretation of the law. The court held that the government failed to state a cause of action in equity. The court reasoned: "When once paid, a tax is gone, and a refund of the money does not restore it." Id. at 193. Nonetheless, the court noted that the complaint did state a cause of action at law.

We find neither Young nor Kelley controlling. Neither case addresses the issue before this court: whether

the government may reassess a taxpayer's tax liability, thus creating a new tax obligation. In Young, the statutory period for reassessment had expired. In Kelley, the government could not have reassessed the taxpayer's liability because the original assessment was neither imperfect nor incomplete.

[3] If the Code authorizes the government to "reassess" Brookhurst's tax liability and to collect by levy the reassessed taxes, we must uphold the government's collection of Brookhurst's 1983 fourth quarter employment taxes. Reviewing the statute, we conclude that the government was entitled to collect by levy the unpaid taxes in the present

action. Code section 6204(a) clearly permits the government to reassess an earlier imperfect or incomplete assessment of taxpayer liability if the assessment is completed within three years from the date the tax return was filed. In addition, section 6502 permits the government to collect the reassessed tax by levy within six years after a timely reassessment. Here the initial assessment of Brookhurst's liability was imperfect. The IRS timely reassessed Brookhurst's tax liability within the three year statutory period and collected the taxes owed within the six year collections period.

The legislative history supports this reading. A Senate Report explaining the predecessor of section 7405 states:

> [Section 610] provides that any erroneous refund, of either class, may be recovered by suit brought in the name of the United States if such suit is begun within two years after the making of the refund. Obviously, if the limitations period on the making of assessments has not expired, the erroneous refund may be recovered by assessment in the ordinary manner.

S. Rep. No. 960, 70th Cong., 1st Sess. 42 (1928), reprinted in 1939-1 C.B. (Part 2) 409, 438; see Black Prince Distillery, Inc. v. United States, 586 F.Supp. 1169, 1173 (D.N.J. 1984). Accordingly, we affirm the district court's holding

that the government properly recovered the erroneously refunded monies.[4]

2. Assessment of Interest.

[4] The government points to Code section 6601(a) in support of its authority to assess interest on the erroneously refunded monies. This section provides:

> If any amount of tax imposed by this title (whether required to be shown on a return, or to be paid by stamp or by some other method) is not paid on or before the last date prescribed for payment, interest on such amount at the underpayment rate established under section

---

[4]The reassessed taxes properly included the $1,907.52 in interest that the government paid to Brookhurst in the erroneous refund of May 8, 1984. See Treas. Reg. §301.6201-1(a); Ideal Realty Co., 561 F.2d at 1124-25.

> 6621 shall be paid for the period from such last date to the date paid.

26 U.S.C. §6601(a) (1988). Because Brookhurst was liable for employment taxes, the government asserts it is entitled to assess interest for the monies owed pursuant to section 6601(a). Brookhurst notes that under the language of this section, the government may assess interest on taxes "not paid." Brookhurst challenges the government's authority to recover interest on the basis of its earlier-advanced argument that its tax liability was satisfied by the February 1984 payment. As we stated above, we do not agree that Brookhurst satisfied its employment tax obligation. The government's

supplemental assessment of Brookhurst's income taxes created a new tax liability which Brookhurst was obligated to pay.

[5] We reject Brookhurst's suggestion that it is unfair for it to be charged interest when it promptly notified the government of the error. Interest is not a penalty. The government paid interest to Brookhurst along with the refund when it believed that it had improperly enjoyed the use of Brookhurst's money. Similarly, Brookhurst must now pay interest on "the theory that for the period during which the taxes were owed but unpaid taxpayer 'had use of funds which rightfully should have been in

the possession of the United States' and should be charged for such use as an ordinary debtor." United States v. Northwestern Mutual Ins. Co., 315 F.2d 723, 726 (9th Cir. 1963) (citation omitted).

Because Brookhurst presents no further challenges to the government's ability to collect interest on the monies, we need only determine whether the government correctly calculated the amount of interest owing. This requires us to decide whether interest should be assessed from the date the return was due or from the date on which the government refunded the monies. In United States v. Northwestern Mutual Ins. Co., 315 F.2d 723 (9th Cir.

1963), we held that section 6601 authorizes the government to assess interest from the date the tax return must be filed, "even if identification of the actual amount of tax liability requires reference to later redetermination by the Commissioner caused by changed circumstances or disagreement with the return." Id. at 725. Under this rule, a taxpayer who initially failed to satisfy his tax liability is obligated to pay interest on the taxes due from the date the tax return should have been filed, regardless of whether the failure to pay resulted from the taxpayer's miscalculation or the government's redetermination of the tax liability.

This rule is not applicable in the present case. Here Brookhurst correctly assessed its tax liability and timely paid its taxes. These taxes remained paid until the government erroneously refunded the monies on May 10, 1984. In a similar situation, the Second Circuit concluded that interest begins to accumulate "when a tax becomes both due and unpaid." Avon Products, Inc. v. United States, 588 F.2d 342, 344 (1978). The purpose of section 6601 is best served by this interpretation of the rule. A taxpayer who timely pays his taxes is not penalized when the government erroneously refunds those monies. Rather, the taxpayer is charged interest only for the time

he had the use of funds which rightfully belonged to the United States.

[6] We conclude that the government properly assessed interest on the erroneously refunded monies from May 10, 1984, the date on which Brookhurst's taxes became both unpaid and due. We therefore reverse the district court's determination that the government lacked statutory authority to collect interest on the refunded monies from that date.

As a result of our decision, we reject Brookhurst's request for attorneys' fees and costs. 26 U.S.C. §7430.

The decision on Brookhurst's appeal is AFFIRMED. The decision on

the government's cross-appeal is REVERSED.

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BROOKHURST, INC., AS SUCCESSOR BY MERGER WITH COMMERCIAL UNIFORM COMPANY, Plaintiff-Appellant, v. UNITED STATES OF AMERICA, Defendant-Appellee.	)	No. 89-55228 D.C. No. CIV 87-03835-JGD
BROOKHURST, INC., AS SUCCESSOR BY MERGER WITH COMMERCIAL UNIFORM COMPANY, Plaintiff-Appellee, v. UNITED STATES OF AMERICA, Defendant-Appellant.	)	No. 89-55265 D.C. No. CIV 87-03835-JGD ORDER

Before CANBY, RYMER, CJJ; Levi, DJ.

Costs are hereby awarded to the United States.

Filed: June 15, 1991

APPENDIX B

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

BROOKHURST, INC., AS SUCCESSOR BY MERGER WITH COMMERCIAL UNIFORM COMPANY,	Case No. CIV 87-03835-JGD
Plaintiff,	
v.	JUDGMENT
UNITED STATES OF AMERICA,	
Defendant.	

In accordance with the Findings of Fact and Conclusions of Law signed and filed on October 26, 1988,

IT IS ORDERED AND ADJUDGED that Plaintiff BROOKHURST, INC. shall recover from Defendant UNITED STATES, the sum of $94,804.90 plus interest at the rate provided by 26 U.S.C.

§6621(a)(1) from December 1, 1988 through the date of payment.

Dated: January 13, 1989

/s/
JOHN D. DAVIES, UNITED STATES DISTRICT JUDGE

APPROVED AS TO FORM:

HOCHMAN, SALKIN & DeROY
A Professional Corporation

By: /s/
CHARLES P. RETTIG, ESQ.

Attorneys for Plaintiff
BROOKHURST, INC.

ROBERT C. BONNER, ESQ.
UNITED STATES ATTORNEY
Charles H. Magnuson, Esq.
Assist. United States Atty.
Chief, Tax Division

By: /s/
A. LAVAR TAYLOR, ESQ.
Asst. U. S. Attorney

Attorneys for UNITED STATES OF AMERICA, Defendant

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

BROOKHURST, INC., AS SUCCESSOR BY MERGER WITH COMMERCIAL UNIFORM COMPANY, Plaintiff, v. UNITED STATES OF AMERICA, Defendant.	Case No. CIV 87-03835-JGD FINDINGS OF FACT AND CONCLUSIONS OF LAW

This case came on for trial on July 25, 1988. The Court, having considered the evidence submitted at trial and all papers on file, hereby makes the following Findings of Fact and Conclusions of Law.

FINDINGS OF FACT

1. The Court has jurisdiction over this action pursuant to 28

U.S.C. §1346(a)(1) and 26 U.S.C. §7422(a).

2. This tax refund suit was instituted by the plaintiff, Brookhurst, Inc., as successor by merger with Commercial Uniform Company.[1] Plaintiff seeks to recover $274,508.44 in employment tax, interest and statutory additions for the fourth quarter of 1983, plus interest thereon. Plaintiff contends that the Internal Revenue Service erroneously collected this sum. The facts underlying this action have

---

[1]In December 1986, Commercial Uniform Company, a California corporation, merged into Brookhurst, Inc. Although most of the events occurred prior to the time of the merger, the term "plaintiff", as used herein, shall include both Brookhurst, Inc. and the Commercial Uniform Company.

been stipulated to in the Amended Pre-Trial Conference Order.

3. On January 21, 1984, plaintiff filed its Employer's Quarterly Federal Tax Return (Form 941) for the fourth quarter of 1983, and reported thereon a $194,874.76 employment tax liability. This $194,874.76 was paid to the United States through periodic federal tax deposits and by way of two payments made in January and February 1984.

4. On May 7, 1984, an authorized representative of the Internal Revenue Service assessed plaintiff's employment tax liability for the fourth quarter of 1983. Instead of assessing the reported $194,874.76 tax liability, however,

the assessment was mistakenly entered upon the assessment rolls in the amount of $971.82. This incorrect assessment resulted in the mistaken entry of a tax credit for the fourth quarter of 1983, which in turn resulted in the mistaken recording of an overpayment of $193,902.04. ($194,874.76 less $971.82) for that quarter. This chain of events caused the mistaken payment to plaintiff of a tax refund, including interest, in the amount of $195,810.51 with respect to plaintiff's fourth quarter 1983 employment tax.

5. By Notice dated May 7, 1984, the Internal Revenue Service notified plaintiff that it would receive a refund in the amount of

$193,902.94. Upon receipt of the Notice, plaintiff returned a copy of the Notice to the Internal Revenue Service with the notation--"our records indicate that our return was correctly filed. Please review your records and advise. Thank you."

6. The erroneous refund check dated May 8, 1984, was received by plaintiff on or about May 10, 1984. Shortly thereafter, plaintiff negotiated the $195,810.51 check and deposited the proceeds into its corporate bank account.

7. In May 1986, Internal Revenue Service personnel realized that the Internal Revenue Service had incorrectly issued the $195,810.51 check to plaintiff.

8. On May 19, 1988, the Internal Revenue Service entered a new employment tax assessment for the fourth quarter of 1983 in the amount of $193,902.91, plus interest of $57,234.34. A notice of demand for this liability was issued to plaintiff on the same day. Prior to May 19, 1986, the Internal Revenue Service had not taken any action to recover the erroneous refund.

9. Through levies issued between December 1986 and March 1987, the United States collected the newly assessed employment tax for the fourth quarter of 1983 in the amount of $193,902.44, plus $72,671.09 in interest, $7,898.44 in failure-to-pay penalties, and $36.00 in fees and

collection costs for a total of $274,508.44.

10. The Internal Revenue Service declined to abate interest on the erroneous refund despite a demand by plaintiff for an abatement of such interest.

11. thereafter, plaintiff filed an administrative Claim for Refund to recover the $274,508.44. By letter dated April 15, 1987, the Internal Revenue Service denied plaintiff's Claim for Refund. Plaintiff exhausted its administrative remedies by registering a protest to the Revenue Officer involved with this case and by filing the administrative Claim for Refund.

12. The Internal Revenue Service has never commenced an action pursuant to 26 U.S.C. §7405 to recover the erroneous refund.

13. Any of the above Findings of Fact shall be deemed Conclusions of Law, and any Conclusions of Law shall also be deemed Findings of Fact.

CONCLUSIONS OF LAW

1. The Secretary of the Treasury, through his duly authorized delegates, is authorized and required to make assessments of all taxes (including interest, penalties, and other statutory accruals) imposed by the Internal Revenue Code. 26 U.S.C. §6201(a). The Internal Revenue Code imposes an employment tax on

employers such as plaintiff. 26 U.S.C. §3101(a), 3102, 3402, and 3403. Thus, the $193,902.91 employment tax, not having been previously assessed by the Secretary, was newly assessed on May 19, 1986. This assessment was required under 26 U.S.C. §6201(a).

2. A tax may be assessed within three years after the return is filed. 26 U.S.C. §6501(a). Plaintiff's employment tax return for the fourth quarter of 1983 was filed on January 21, 1984. Since the $193,902.91 employment tax liability for the fourth quarter of 1983 was newly assessed on May 19, 1986, it was timely made pursuant to 26 U.S.C. §6501(a).

3. Where an assessment of tax is timely made, the tax may be collected by levy within six years after the assessment. 26 U.S.C. §6502(a). The $193,902.91 employment tax assessment at issue was entered on May 19, 1986. The United States collected this tax, plus interest and other statutory additions thereon by levy in December 1986, January 1987, and March 1987. Thus, the collection of the assessed tax, plus interest and statutory additions, was also timely made.

4. The employment tax at issue was assessed within the time period provided in 26 U.S.C. §6501(a). It was collected within the limitation period imposed by 26 U.S.C. §6502(a).

Therefore, the United States had authority to recover the tax which was assessed on May 19, 1986.

5. The Internal Revenue Service did not have authority to include interest in the May 19, 1986 assessment, however. The government argues that the authority to collect interest on the amount of taxes assessed is based on 26 U.S.C. §6201(a). Section 6201(a) provides that the "Secretary is authorized and required to make . . . assessments of all taxes (including interest, additional amounts, additions to the tax, and assessable penalties) imposed by this title, ..." That section provides that the government can assess taxes and interest

otherwise imposed by statute. However, that section does not itself provide a basis for imposing interest. The government has not established a statutory basis for imposing interest pursuant to the Internal Revenue Code. Therefore, the Secretary does not have the authority to assess interest against the plaintiff.[2]

---

[2]Plaintiff argues that the interest assessed should be abated pursuant to 26 U.S.C. §6404(e). Since the Court determined that interest was not properly assessed in the first instance, the Court did not reach the issue of abatement. Nevertheless, it appears that abatement of interest for employment taxes is not authorized pursuant to 26 U.S.C. §6404(e). The provisions of section 6404(e)(1) do not apply to employment taxes. See Treasury Reg. §301.6402-2T(a); Rev. Proc. 87-42, §2.02, reprinted in 1987-2 Cum. Bull. 589 (1987). Section 6404(e)(2) provides for abatement unless the

6. The government also does not have the authority to assess interest pursuant to 26 U.S.C. §6601(a). Section 6601(a) only provides for the imposition of interest if "any amount of tax imposed by this title. . . is not paid on or before the last date prescribed for payment." Since plaintiff timely paid all taxes assessed prior to May 19, 1986, the government is not entitled to interest.

7. The Internal Revenue Service had no authority to impose a failure to pay penalty pursuant to 26 U.S.C. §6651(a)(3). That section

---

refund exceeds $50,000.00. The amount in question in this case exceeds $50,000.00.

permits assessment of a penalty only if the taxpayer has failed to pay any tax required to be shown on a return. Plaintiff filed the appropriate tax returns and paid all taxes required to be shown on the returns in 1984. In addition, plaintiff had reasonable cause for not paying the tax assessed on May 19, 1986.

8. Plaintiff adequately raised the issue of penalties by seeking return of the $274,508.44 collected by the United States, which includes $7,898.44 in penalties.

9. Plaintiff also timely raised and preserved the issue of penalties by arguing at trial and in Plaintiff's Trial Brief that penalties should not be imposed.

Thus, the government had an adequate opportunity to address the issue of penalties and was not prejudiced by plaintiff's failure to more specifically address this issue earlier.

10. Any of the above Conclusions of Law shall be deemed Findings of Fact, and any Findings of Fact shall also be deemed Conclusions of Law.

IT IS SO ORDERED.

DATED: October 26, 1988

/s/
JOHN G. DAVIES
United States District Judge

APPENDIX C

APPENDIX C

26 U.S.C. §6651(a)(2)

> (a) Addition to the tax.--In case of failure--
>
> . . . (2) to pay the amount shown as tax on any return . . . on or before the date prescribed for payment of such tax . . . there shall be added to the amount shown as tax on such return 0.5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 0.5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate, ...

26 U.S.C. §6656(a)

> In case of failure by any person required by this title or by regulation of the Secretary under this title to deposit on the date prescribed therefor any amount of tax imposed by this title in such government depositary as is

authorized under section 6302(c) to receive such deposit, unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be imposed upon such person a penalty of 5 percent of the amount of the underpayment.

26 U.S.C. §6672(a)

Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable.

26 U.S.C. §7202

Any person required under this title to collect, account for, and pay over any tax imposed by this title who willfully fails to collect or truthfully account for and pay over such tax shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution.

(3)

No. 91-133

Supreme Court, U.S.
FILED
SEP 17 1991
OFFICE OF THE CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1991

BROOKHURST, INC., AS SUCCESSOR BY MERGER WITH COMMERCIAL UNIFORM COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

KENNETH W. STARR
Solicitor General

SHIRLEY D. PETERSON
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QUESTION PRESENTED

1. Whether the Internal Revenue Service may issue a corrected tax assessment pursuant to Section 6204(a) of the Internal Revenue Code in order to collect an erroneously refunded employment tax.

2. Whether, pursuant to Section 6601(a) of the Internal Revenue Code, interest accumulates on the unpaid taxes from the date petitioner received the erroneous refund.

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In the Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-133

BROOKHURST, INC., AS SUCCESSOR BY MERGER WITH COMMERCIAL UNIFORM COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A24) is reported at 931 F.2d 554. The opinion of the district court (Pet. App. B3-B17) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on April 24, 1991. The petition for a writ of certiorari was filed on July 22, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES INVOLVED

1. Section 6204(a) of the Internal Revenue Code, 26 U.S.C. 6204(a), provides:

> The Secretary may, at any time within the period prescribed for assessment, make a supplemental assessment whenever it is ascertained that any assessment is imperfect or incomplete in any material respect.

2. Section 6501(a) of the Internal Revenue Code, 26 U.S.C. 6501(a), provides in relevant part:

> Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed * * *.

3. Section 6502(a) of the Internal Revenue Code, 26 U.S.C. 6502(a), provides in relevant part:

> Where the assessment of any tax imposed by this title has been made within the period of limitation properly applicable thereto, such tax may be collected by levy or by a proceeding in court, but only if the levy is made or the proceeding begun—
>
> (1) within 6 years after the assessment of the tax * * *.

4. Section 6601(a) of the Internal Revenue Code, 26 U.S.C. 6601(a), provides in relevant part:

> If any amount of tax imposed by this title * * * is not paid on or before the last date prescribed for payment, interest on such amount * * * shall be paid for the period from such last date to the date paid.

STATEMENT

1. On January 21, 1984, petitioner filed its Employer's Quarterly Federal Tax Return for the fourth quarter of 1983. That return reported an employment tax liability of $194,874.76, which was paid.

Thereafter, an Internal Revenue Service (IRS) agent mistakenly assessed petitioner's liability for that quarter as $971.82. Because of this erroneous assessment, the IRS informed petitioner on May 7, 1984, that it would receive a refund. The IRS mailed the refund check in the amount of $195,810.51 to petitioner on May 8, 1984. The amount of the refund included interest. Pet. App. A2-A4.

On May 10, 1984, petitioner cashed the check and deposited the proceeds into its corporate bank account. Petitioner also returned a copy of the refund notice to the IRS with the notation "our records indicate our return was correctly filed. Please review your records and advise. Thank you." Pet. App. A4. Petitioner, however, never returned or attempted to return the erroneous refund to the IRS. *Ibid.*

Approximately two years later, the IRS discovered its mistake. On May 19, 1986, the IRS therefore made a supplemental assessment of $193,902.91 against petitioner for employment taxes due for the fourth quarter of 1983 and also assessed $57,234.34 in interest. After notice and demand for payment, petitioner refused to pay. The IRS then levied against petitioner's bank accounts and collected the assessed tax, interest and collection costs.[1] Pet. App. A4-A5.

2. Petitioner commenced an action to recover the amounts collected by the IRS. Petitioner contended that the government's exclusive remedy was a suit to recover the "erroneous refund" under Section 7405 of the Internal Revenue Code and that the two-year

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[1] The IRS also assessed and collected a penalty under Section 6651(a) of the Code, 26 U.S.C. 6651(a), for failure to pay the tax in a timely manner. The district court held that, in these circumstances, a late-payment penalty was not proper (Pet. App. B15-B16). The government did not challenge that determination on appeal.

limitations period for bringing such a suit had expired. Pet. App. A8-A9. Petitioner also contended that, because the underpayment in tax was due to the government's error, petitioner should not be liable for the interest imposed under Section 6601 of the Code. *Id.* at A18-A19.

The district court held (Pet. App. B10-B13) that, while an "erroneous refund" suit under Section 7405 was time-barred, the United States had validly issued a corrected assessment under Section 6204(a) within the three-year period allowed under Section 6501(a) and had thereafter validly collected the newly assessed employment tax within the six-year period allowed by Section 6502(a). The court agreed with petitioner, however, that the United States was not entitled to assess interest on the unpaid tax under Section 6601(a). See Pet. App. B13-B14.

3. Both parties appealed. The court of appeals affirmed the district court's ruling that the United States properly corrected its assessment and collected the erroneously refunded employment taxes. Pet. App. A7-A17. The court reversed, however, the district court's ruling that the United States was not entitled to assess interest on the tax, concluding that Section 6601(a) authorized the government to assess and collect interest from the date the IRS made the erroneous refund. Pet. App. A17-A23.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or of any other court of appeals. Further review is therefore not warranted.

1. Pursuant to Section 6201(a) of the Internal Revenue Code, the IRS is "authorized and required" to make assessments of taxes imposed by the Code. Section 6204(a) of the Code further provides that the IRS "may, at any time within the period for assessment, make a supplemental assessment whenever it is ascertained that any assessment is imperfect or incomplete in any material respect." 26 U.S.C. 6204(a). Section 6501(a) allows such assessments to be made at any time "within 3 years after the return was filed * * *." 26 U.S.C. 6501(a). The court of appeals thus correctly held (Pet. App. A14-A15) that, because the original assessment was incorrect, the government was authorized by Section 6204(a) to issue a corrected assessment of petitioner's tax liability within the three-year period allowed by Section 6501(a).

Notwithstanding the clear language of these provisions, petitioner contends (Pet. 26-37) that the government's *exclusive* means for recovery was not by issuance of a corrected assessment under Section 6204(a) but was instead by commencing an action for recovery of an "erroneous refund" under Section 7405 of the Code. Petitioner claims that, since the two-year statute of limitations for bringing suit under Section 7405 had expired (see 26 U.S.C. 6532), the government was barred from collecting the tax.[2]

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[2] Section 7405(b) provides (26 U.S.C. 7405(b):

> Any portion of a tax imposed by this title which has been erroneously refunded (if such refund would not be

Petitioner's argument is incorrect. When Congress has created two different methods for recovery of a tax, the fact that one method may be barred by a statute of limitations does not prohibit recovery under the other. See *United States* v. *Whited & Wheless, Ltd.*, 246 U.S. 552, 554 (1918); *Beer* v. *Commissioner*, 733 F.2d 435, 436 (6th Cir.), cert. denied, 469 U.S. 857 (1984). Indeed, the legislative history of Section 7405 expressly reflects that Congress specifically understood and intended that these two alternatives for recovery of a tax following an erroneous refund were *not* mutually exclusive. The Senate report accompanying the original enactment of Section 7405 (then Section 610 of the Revenue Act of 1928, ch. 852, 45 Stat. 875) stressed that, while an "erroneous refund" suit was authorized by that statute "within two years after the making of the refund,"

> [o]bviously, *if the limitation period on the making of assessment has not expired, the erroneous refund may be recovered by assessment in the ordinary manner.*

S. Rep. No. 960, 70th Cong., 1st Sess. 42 (1928) (emphasis added). Several courts have held that this legislative history squarely refutes petitioner's claim that an "erroneous refund" action under Section 7405 is the exclusive remedy available to the United States in these circumstances. See Pet. App. A16; *Beer* v. *Commissioner*, 733 F.2d at 436-437; *Ideal Realty Co.*

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considered as erroneous under section 6514) may be recovered by civil action brought in the name of the United States.

Section 6532(b) provides (26 U.S.C. 6532(b)):

Recovery of an erroneous refund by suit under section 7405 shall be allowed only if such suit is begun within 2 years after the making of such refund * * *.

v. *United States*, 561 F.2d 1123, 1125 (4th Cir. 1977); *Warner* v. *Commissioner*, 526 F.2d 1 (9th Cir. 1975).[3]

As the court of appeals concluded in this case (Pet. App. A15), because the original tax assessment was in error, Section 6204(a) authorizes a supplemental assessment to correct that error. The supplemental assessment was timely made under Section 6501(a) and was timely collected under Section 6502(a). There is no conflict among the courts of appeals on the issue presented and addressed in this case.[4]

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[3] Petitioner errs in relying (Pet. 11-17) on cases that involve the different question of when taxes are deemed "paid" for purposes of determining the statute of limitations for a refund claim. See, *e.g.*, *Rosenman* v. *United States*, 323 U.S. 658 (1945); *Ehle* v. *United States*, 720 F.2d 1096 (9th Cir. 1983); *Ford* v. *United States*, 618 F.2d 357 (5th Cir. 1980); *Ameel* v. *United States*, 426 F.2d 1270 (6th Cir. 1970); *Fortugno* v. *Commissioner*, 353 F.2d 429 (3d Cir. 1965); *Plankinton* v. *United States*, 267 F.2d 278 (7th Cir. 1959); *Thomas* v. *Mercantile Nat'l Bank*, 204 F.2d 943 (5th Cir. 1953); *United States* v. *Dubuque Packing Co.*, 233 F.2d 453 (8th Cir. 1956). See generally 15 J. Mertens, *Law of Federal Income Taxation*, §§ 58.55-58.57 (1989). That issue is not presented in this case.

[4] Petitioner cites several cases (Pet. 18-26) that involve the factually and legally different situation that arises when the IRS issues an erroneous refund after it makes an *accurate* assessment of taxes and thereafter issues no supplemental or corrected assessment. In that circumstance, some courts have held that the IRS must pursue an "erroneous refund" suit under Section 7405 because there is no outstanding assessed tax liability to collect administratively. See, *e.g.*, *Kelley* v. *United States*, 30 F.2d 193 (9th Cir. 1929); *Rodriguez* v. *United States*, 629 F. Supp. 333 (N.D. Ill. 1986); *United States* v. *Young*, 79-2 U.S.T.C. ¶ 9609 (D. Del. 1979). But see *Burns* v. *United States*, 90-2 U.S.T.C. ¶ 50,479 (S.D. Fla. 1990) (IRS was not prohibited from collecting by levy tax

2. Section 6601 of the Code requires that interest be imposed on taxes that are not paid on the date that they are due. See *Bowman* v. *United States*, 824 F.2d 528, 531 (6th Cir. 1987); *United States* v. *Means*, 621 F.2d 236, 238 (6th Cir. 1980); *Williams* v. *United States*, 667 F.2d 1108, 1111 (4th Cir. 1981). The interest provided by Section 6601 is not a penalty for late payment; instead, it represents compensation to the government for the delayed payment of taxes. *United States* v. *Childs*, 266 U.S. 304, 309-310 (1924); *Grauvogel* v. *Commissioner*, 768 F.2d 1087, 1090 (9th Cir. 1985); *Johnson* v. *United States*, 602 F.2d 734, 737 (6th Cir. 1979); *Vick* v. *Phinney*, 414 F.2d 444, 448 (5th Cir. 1969). The court of appeals correctly held that interest was due on the erroneously refunded monies from the date petitioner received such funds because that was the date from which petitioner "had the use of funds which rightfully belonged to the United States" (Pet. App. A23).[5] See *Bowman*

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assessments, which had once been paid, when taxpayer revived underlying assessment by obtaining and depositing an IRS refund check). Cf. *Tucker* v. *United States*, 89-1 U.S.T.C. ¶ 9336 (S.D.N.Y. 1989) (IRS issued refund before it timely assessed taxes; therefore its levy to collect taxes was proper); *Pesch* v. *Commissioner*, 78 T.C. 100, 120 (1982) (same). That, of course, is not the situation presented by this case. Instead, this case involves the different situation precisely addressed in the legislative history where the agency issued an *incorrect* original assessment and "[o]bviously" would be permitted to issue a timely, corrected assessment in order to collect the taxes due. See Pet. App. 16A; S. Rep. No. 960, *supra*, at 42.

[5] Petitioner's contention (Pet. 40-41) that Section 6602 of the Code limits the government's recovery of interest is in error. That Section applies only to Section 7405 of the Code. The government was not limited to, and did not pursue, an erroneous refund suit in this case.

v. *United States*, 824 F.2d at 531; *Cibelli* v. *United States*, 585 F. Supp. 799, 800-801 (D. Conn. 1984). There is no conflict among the courts of appeals nor other reason to justify further review.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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